



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Release Number: **201315028**  
Release Date: 4/12/2013  
Date: January 15, 2013  
UIL Code: 501.33-01

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz  
Director, Rulings and Agreements

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: September 17, 2012

UIL Code: 501.33-01

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend

State Program =

State Office =

Medical Practice =

Dear

We have considered your application for recognition of exemption from federal income tax under § 501(a) of the Internal Revenue Code (the "Code"). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

Facts

You were incorporated in 2011 as a nonprofit corporation under state law. Your Articles of Incorporation state that your purposes are to:

*Redesign healthcare delivery around the patient-centered medical home model, thereby improving quality of healthcare while reducing healthcare cost.*

Your Bylaws state that you are "organized exclusively for charitable and educational purposes, more specifically to provide health and human services to adults and children."

You state that your mission is to:

*...create value for [your] members while redesigning the delivery of medical care around the patient centered medical home (PCMH) model, [which] may in time create opportunities for further integration with other organizations, including independent groups of physician specialists, hospitals, pharmaceutical companies, regional extension centers, and entities that share similar interests in delivering accountable, high quality, and reduced cost medical care.*

*As value-added opportunities become evident, [you] will pursue integrating models of growth and transformation that serve [your] members [sic] independence, focusing on the proliferation of private practice, while providing supplemental support to address cost-effective operational responsibilities and services that will enhance their financial viability.*

Your members are medical practices that contract with you for your services, also referred to as "engaged practices." You are not a membership organization, *per se*. You state that your member services will include:

- *Membership education and collaboration, sharing of operating efficiencies and successfully implementing PCMH principles.*
- *A forum to capitalize on economies of scale, engaging products and services that enhance practice performance and increase the financial performance of member practices.*
- *Analytical technologies to assess member performance and provide opportunities to enhance billing practices, while providing compliance and documentation standards that meet all regulatory requirements.*
- *Enhanced payments by payors for services provided by members and a "fair" sharing of cost savings realized by payors.*
- *Specifically,*
  - *Conduct an initial overview assessment of each member's practice.*
  - *Develop standards that meet NCQA requirements, assisting members to level three certification, while expanding operational compliance to meet government and payor expectations.*
  - *Develop standards that meet EHR meaningful use criteria to meet government and payor expectations.*
  - *Develop a "best practices" repository from existing members and other leading organizations.*
  - *Develop the patient data accumulation repository within each member practice, needed to conduct outcomes research.*
  - *Develop data analysis relationships with research organizations, interpreting relevant information for publication.*
  - *Generate a publication outlining the successful delivery of health care using the PCMH model.*
  - *Negotiate on behalf of the members' insurance companies for higher reimbursement using the principles of PCMH below.*
  - *Negotiate on behalf of the members a sharing of the cost savings realized by payors, rewarding members for the efforts.*
  - *Negotiate with business and industry, rewarding members for their cost-saving efforts.*

Your proposed activities to develop the PCMH concept also include recruiting medical practices, setting clinical standards, data collection and analysis, staff training, and practice to practice consultation. You will use the data to provide feedback to your engaged medical practices to "identify potential areas for improvement."

You state that you are "organized and operated exclusively for the purpose of educating medical professionals in implementation and use of the medical home model to improve the quality of healthcare while reducing healthcare costs." You also state that as you implement and spread

*...medical home concepts into medical practices, the resulting improvements in healthcare quality and reductions in healthcare costs will create a desirable network of engaged practices. In order to achieve significant and permanent changes in America's healthcare, namely improved quality and reduced cost, health insurers must recognize practices that provide such care and increase reimbursement to such practices to fund ongoing improvements.*

*Once practices engaged by [you] demonstrate improved healthcare quality and reduced healthcare costs, [you] will advertise these improvements to business and industry to attract greater interest from insurers, other lines of business, and patients. As demand for medical care by [your] engaged practices increases, engaged practices can command better reimbursement, additional resources, and other funding sources.*

Although you state that you will contract with your members for your services, it appears that you will provide such services for free. You state that you hope to fund your activities solely through private, state, and federal grants.

You state that you are an outgrowth of State Program, which is overseen by State Office. You state that you intend to contract with medical practices participating in State Program to continue developing the patient-centered medical home concept after State Program ends. However, you do not have any direct relationship with State Program. You have not yet contracted with any medical practices participating in State Program, but you were "created by individuals within practices who participate in [State Program] for this purpose."

You have a close relationship with Medical Practice, a taxable corporation. Although you did not disclose this information on your Form 1023 application, we attempted to contact you, then reached the phone number of Medical Practice. Medical Practice's sole shareholder is married to your president, who is also an employee of Medical Practice. Your president and two other Medical Practice employees comprise your board of directors. Although your correspondence dated July 20 , states that your management activities "will be conducted in rented office space," your correspondence dated September , 20 , states that in fact Medical Practice provides you with office space, telephone, fax, internet, office support and office supplies for no charge, but that you have no formal agreement with Medical Practice for the use of such items. Medical Practice is also a participant in State Program.

#### Law

Section 501(c)(3) describes a corporation organized and operated exclusively for charitable, educational, and other purposes, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) states that to be described in § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(iii) states that an organization is not organized exclusively for one or more exempt purposes if its articles of organization expressly empower it to carry on, as more than an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be regarded as exempt if more than an insubstantial part of its activities further a non-exempt purpose.

Section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirements of this subsection, an organization must establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in § 501(c)(3) in its generally accepted legal sense and includes such purposes as relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; and lessening of the burdens of Government. A determination of whether an organization is lessening the burdens of government requires consideration of whether the organization's activities are ones that a government unit considers to be its burden, and whether such activities actually lessen that burden, based on all the facts and circumstances. See Rev. Rul. 85-1 (organization that assists a county's law enforcement agencies in policing illegal narcotics traffic lessens burdens of government); Rev. Rul. 85-2 (organization that provides legal counsel and training to volunteers who serve as guardians ad litem in a juvenile court dependency program lessens the burdens of government). In addition, the promotion of health has long been recognized as a charitable purpose. See *Restatement (Second) of Trusts*, §§ 368, 372 (1959); 4A Austin W. Scott and William F. Fratcher, *The Law of Trusts* §§ 368, 372 (4th ed. 1989).

Section 1.501(c)(3)-1(d)(3)(i) includes in the definition of educational activities the instruction or training of the individual for the purpose of improving or developing his capabilities and the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(d)(5) states that a "scientific" organization must be organized and operated in the public interest. Research is not synonymous with "scientific;" and the nature of particular research depends on the purpose which it serves. Scientific research does not include activities incidental to commercial or industrial operations. Scientific research is treated as being carried on in the public interest if, among other things, the results of such research are made available to the public on a nondiscriminatory basis.

Rev. Rul. 69-545, 1969-2 C.B. 117, holds that a non-profit hospital that benefits a broad cross section of its community by having an open medical staff and a board of trustees broadly representative of the community, operating a full-time emergency room open to all regardless of ability to pay, and otherwise admitting all patients able to pay (either themselves, or through third party payers such as private health insurance or government programs such as Medicare) may qualify as an organization described in § 501(c)(3).

Rev. Rul. 71-529, 1971-2 C.B. 234, holds that a nonprofit organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption under § 501(c)(3). By providing such services to its members, the organization is performing an essential function for charitable organizations. By performing this function for the organizations for a charge that is substantially below cost, the organization is performing a charitable activity within the meaning of § 501(c)(3).

Rev. Rul. 72-369, 1972-2 C.B. 245, holds that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under § 501(c)(3). The organization enters into agreements with unrelated nonprofit organizations to furnish managerial and consulting services on a cost basis. The services consist of writing job descriptions and training manuals, recruiting personnel, constructing organizational charts, and advising organizations on specific methods of operation. These activities are designed for the individual needs of each client organization. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of § 501(c)(3). Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Rev. Rul. 74-614, 1974-2 C.B. 164, describes an organization that was created and controlled by tax-exempt colleges and universities. The organization devised and operated a regional computer network to enable its member institutions, including faculties and students, to benefit from research and scientific information developed by other member institutions and the federal government. It conducts an information clearinghouse responsive to the research needs of its member-users. The computer network is not used for administrative matters such as class scheduling, billing, or processing applications. The organization is supported by governmental grants, contributions, and membership dues. The ruling concluded that the organization is advancing education.

Rev. Rul. 76-455, 1976-2 C.B. 150, involves a nonprofit that was organized to encourage and assist in the establishment of nonprofit regional health data systems; to conduct scientific studies with regard to quality, utilization, and effectiveness of health care agencies; to educate

those involved in health care as to the deficiencies in the quality, utilization, and effectiveness of health care and health care agencies; and to make proposals to remedy such deficiencies. It provided all services to health care institutions, government bodies and the general public without charge. The ruling concludes that the research and study are carried on to provide educational and scientific benefits to the general public and therefore it qualifies for exemption under § 501(c)(3).

Rev. Rul. 77-69, 1977-1 C.B. 143, describes an agency that was organized and operated pursuant to federal statute to establish and maintain a system of health planning and resource development aimed at providing adequate health care for a specified geographic area. It was funded by federal grants and managed by government officials and members of the public. The organization gathered and analyzed health data, established health system plans and goals, coordinated activities with professional standards review organizations, reviewed and approved grant applications for federal funds, and assisted states in reviewing health services capital expenditures. The organization promoted the health of the residents of the area in which it functioned, and met the requirements of lessening the burdens of government, and therefore operated for charitable purposes under § 501(c)(3).

Rev. Rul. 80-287, 1980-2 C.B. 185, provides that a nonprofit lawyer referral service does not qualify for exemption under § 501(c)(3). The organization aided persons who did not have an attorney by helping them select one, in exchange for a nominal service charge. Any attorney who was a member of a local bar association could apply for placement on the referral list, in exchange for an application fee. Because a substantial purpose of the organization was aiding the legal profession, the organization was not organized or operated exclusively for charitable purposes, even though its lawyer referral service did provide some public benefit.

Rev. Rul. 81-29, 1981-1 C.B. 329, describes an organization that otherwise qualified for exemption under § 501(c)(3). It assists academic research libraries and agencies and other library organizations in exchanging bibliographic information through a computer network. The organization did not provide other services, such as routine administrative services, to its member libraries. Its members include historical societies and libraries of colleges and universities, which are exempt under § 501(c)(3), and libraries of state and federal governmental agencies, as well as non-exempt libraries of business entities. The organization derives its income from each of its member libraries for the cost of computer time used plus service charges. This ruling concluded that, by making bibliographic information available to researchers, the organization advances education within the meaning of § 501(c)(3) and § 1.501(c)(3)-1(d)(2). The fact that the information is furnished to non-exempt libraries does not detract from the educational value of the information itself.

Rev. Rul. 81-276, 1981-2 C.B. 128, describes a professional standards review organization established pursuant to a federal statute to review health care practitioners' and institutions' provision of health care services and items for which payment is made under Medicare and Medicaid, and determine whether the quality of services met professionally recognized standards of care. The IRS ruled that by taking on the government's burden of reviewing the quality of services provided under Medicare and Medicaid, the organization lessened the burdens of government within the meaning of § 1.501(c)(3)-1(d)(2). Any benefit to members of



the medical profession from such activities was incidental to the benefit the organization provided in lessening the burdens of government. Therefore, the organization qualified for exemption under § 501(c)(3).

Rev. Rul. 85-110, 1985-2 C.B. 166, holds that the performance of diagnostic laboratory testing on referred specimens from private patients of hospital staff physicians, by a hospital exempt under § 501(c)(3), is unrelated trade or business if such services are otherwise available in the community.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

American Institute for Economic Research v. United States, 302 F.2d 934 (Ct. Cl. 1962), cert. denied, 372 U.S. 976 (1963), described an organization that had a stated aim of teaching and disseminating economic knowledge, published two semi-monthly periodicals available for subscription, and provided investment advice services for a fee. The court held that this organization did not qualify for exemption under § 501(c)(3), because its commercial purpose of selling investment advice was primary and not incidental to its educational purpose.

In B.S.W. Group, Incorporated v. Commissioner, 70 T.C. 352 (1978), the Tax Court considered the qualification for exemption under § 501(c)(3) of an organization formed to provide consulting services for a fee to nonprofit and tax exempt organizations in the areas of health and health delivery systems, housing, vocational skills, and cooperative management. In concluding that the organization did not qualify for exemption, the court noted that:

[T]he critical inquiry is whether petitioner's primary purpose for engaging in its sole activity is an exempt purpose, or whether its primary purpose is the nonexempt one of operating a commercial business producing net profits for petitioner. . . . Factors such as the particular manner in which an organization's activities are conducted, the commercial hue of those activities, and the existence and amount of annual or accumulated profits are relevant evidence of a forbidden predominant purpose.

In Federation Pharmacy Services, Inc. v. Commissioner, 72 T.C. 687 (1979), aff'd, 625 F.2d 804 (8<sup>th</sup> Cir. 1980), the court held that, while selling prescription pharmaceuticals to elderly persons at a discount promotes health, the pharmacy did not qualify for recognition of exemption under § 501(c)(3) on that basis alone. Because the pharmacy operated for a substantial commercial purpose, it did not qualify for exemption under § 501(c)(3).

In Washington Research Foundation v. Commissioner, T.C. Memo 1985-570 (1985), the Tax Court held that an organization that facilitates transfer of technology from nonprofit organizations' labs for public use through licensing arrangements with private industry did not qualify for exemption under § 501(c)(3), because the immediate benefit of its activities rebounds to private industry and the nonprofit research institutions, and only indirectly to the general

public, and because these activities are commercial in nature and not in direct furtherance of exempt purposes.

In Church by Mail, Inc. v. Commissioner, 765 F. 2d 1387, 1392 (9th Cir. 1985), aff'g T.C. Memo 1984-349 (1984), the court, in affirming the Tax Court's finding that it was unnecessary to consider the reasonableness of payments made by the applicant to a business owned by its officer, stated, "[t]he critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

In IIT Research Institute v. United States, 9 Cl. Ct. 13, 21 (1985), the Claims Court determined that 11 contracts between an organization and various federal government agencies or federal government contractors constituted "scientific research" within the meaning of § 1.501(c)(3)-1(d)(5) because they:

- 1) Involved the use of observation or experimentation to formulate or verify facts or natural laws;
- 2) Could only have been performed by an individual with advanced scientific or technical expertise;
- 3) Added to knowledge within a particular scientific field;
- 4) Involved the application of mathematical reasoning; and/or
- 5) Involved attempts to systemize or classify a body of scientific knowledge by collecting information and presenting it in a useful form.

The Claims Court also concluded that the term "research," as used in § 1.501(c)(3)-1(d)(5), "...was intended to include not only fundamental research but also applied research such as testing and experimental construction and production." 9 Cl. Ct. at 31.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court held that an organization that as its primary activity operated a school to train individuals for careers as political campaign professionals was not operated exclusively for exempt purposes as described in § 501(c)(3) because the school's activities conferred impermissible private benefit. The court defined "private benefit" as "nonincidental benefits conferred on disinterested persons that serve private interests."

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7<sup>th</sup> Cir. 1991), involved an organization established by the Seventh Day Adventist Church to carry out its "health ministry" through operation of two vegetarian restaurants and health food stores. The court sustained the IRS's denial of tax exemption under § 501(c)(3) because the organization was operated for a substantial non-exempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in competition with other

restaurants, engaged in marketing, and generally operated in a manner similar to commercial businesses.

In Geisinger Health Plan v. Commissioner, 985 F.2d 1210 (3<sup>rd</sup> Cir. 1993), the court held that a pre-paid health care organization that arranges for the provision of health care services only for its members, benefits its members, not the community as a whole. Under the community benefit standard, the organization must benefit the community as a whole to be recognized as promoting health in the charitable sense of § 501(c)(3).

IHC Health Plans, Inc. v. Commissioner, 325 F.3d 1188 (10<sup>th</sup> Cir. 2003), involved an operator of health maintenance organizations that served approximately one-quarter of Utah's residents and approximately one-half of its Medicaid population. The court held that the organization failed to meet the community benefit standard to qualify for exemption under § 501(c)(3) because its sole activity was arranging for health care services for its members, in exchange for a fee. The court said that providing health-care products or services to all in the community is necessary but not sufficient to meet the community benefit standard. Rather, the organization must provide some additional benefit that likely would not be provided in the community but for the tax exemption, and that this public benefit must be the primary purpose for which the organization operates.

## Analysis

### *Organizational Test*

Organizations applying for exemption under § 501(c)(3) must be organized and operated exclusively for charitable, educational, and other purposes. Section 1.501(c)(3)-1(b)(1)(iii) states that an organization is not organized exclusively for one or more exempt purposes if its articles of organization expressly empower it to carry on, as more than an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes. Your Articles of Incorporation as filed with the state corporation authority in your state of incorporation specifically state that you are organized to "[R]edesign healthcare delivery around the patient-centered medical home model, thereby improving quality of healthcare while reducing healthcare cost." Redesigning healthcare delivery is not itself a charitable purpose within the meaning of § 501(c)(3); such activity could be conducted in a manner that would not further charitable purposes. See IHC Health Plans, Inc. v. Commissioner, *supra*.

Although your Bylaws mention you are organized "for charitable and educational purposes," your Articles of Incorporation do not include any exempt purpose. Therefore, your organizational language does not sufficiently limit your permitted activities to charitable activities described in § 501(c)(3) and you do not meet the requirements of § 1.501(c)(3)-1(b)(1)(iii). Accordingly, you fail the organizational test.

### *Operational Test*

To satisfy the operational test under § 1.501(c)(3)-1(c)(1), an organization must establish that it is operated exclusively for one or more exempt purposes. An organization will be regarded as

“operated exclusively” for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). Under the operational test, the purpose towards which an organization’s activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization’s right to be classified as a § 501(c)(3) organization. B.S.W. Group, supra. Your activities are not directed toward one or more exempt purposes, such as the promotion of health, education, or scientific purposes.

### *Promotion of Health*

The promotion of health has long been recognized as a charitable purpose under common law. However, not every activity that generally promotes health furthers exclusively charitable purposes under § 501(c)(3). For example, selling prescription pharmaceuticals promotes health, but pharmacies cannot qualify for recognition of exemption under § 501(c)(3) on that basis alone. Federation Pharmacy Services, Inc., supra. Nor does a hospital primarily further a charitable purpose solely by offering health care services to the public in exchange for a fee. See Rev. Rul. 69-545, supra. Rather, a hospital must be organized and operated primarily for the benefit of the community, as evidenced by such factors as a board that represents the community, operation of an emergency room, provision of charity care, medical training, or medical research. For example, a health maintenance organization that is operated primarily for the purpose of benefiting its paying subscribers does not qualify for exemption solely because the community also derives health benefits from its activities. See Geisinger Health Plan, supra; and IHC Health Plans, Inc., supra.

You do not provide healthcare services directly to patients, unlike the hospital in Rev. Rul. 69-545. Your activities consist of gathering healthcare and business practice data from your engaged practices, analyzing this data, and making the results of your analysis available to your engaged practices through your consulting services. In essence, you are providing information so that the engaged practices can implement a more efficient business model, save costs, and “negotiate with business and industry” to reward your engaged practices for “their cost-saving efforts.”

Furthermore, these services directly and substantially benefit your engaged practices. To the extent the general public benefits from your activities, these benefits are based on and derived from the manner in which the engaged practices choose to use the data they receive from you. The healthcare provider performance data are merely information that your engaged practices may use to reduce the cost of providing healthcare. Thus, to the extent the community may realize benefits from these data is similar to the benefits a community derives when healthcare providers use more effective and efficient medical supplies, equipment, and current health information to diagnose illnesses and diseases and treat their patients. The provision of such tools to healthcare providers generally does not serve exclusively tax-exempt purposes. As the court noted in IHC Health Plans, Inc., supra at 1197:

In giving form to the community-benefit standard, we stress that ‘not every activity that promotes health supports tax exemption under § 501(c)(3). For example, selling prescription pharmaceuticals certainly promotes health, but

pharmacies cannot qualify for . . . exemption under § 501(c)(3) on that basis alone.' Rev. Rul. 98-15. In other words, engaging in an activity that promotes health, *standing alone*, offers an insufficient indicium of an organization's purpose. Numerous for-profit enterprises offer products or services that promote health.

In several revenue rulings, the Internal Revenue Service concluded that an organization was promoting health within the meaning of § 501(c)(3) even though it was not directly providing medical care to patients because it improved the effectiveness of health care provided by others. See Rev Rul. 77-69, supra; and Rev. Rul. 81-276, supra. However, the organizations in these revenue rulings were created pursuant to federal statutes and worked closely with the government to support its health care responsibilities. You were not established pursuant to any federal statute and no government agency supports your activities. Although you state that you are an outgrowth of State Program, which is overseen by State Office, you do not have any direct relationship with State Program. You have not yet contracted with any medical practices participating in State Program, but you were "created by individuals within practices who participate in [State Program] for this purpose."

Therefore, although your activities may indirectly promote health in a general sense, they do not primarily promote health in a charitable manner within the meaning of § 501(c)(3) and § 1.501(c)(3)-1(d)(2).

#### *Education*

Furthering education is an exempt purpose within the meaning of § 501(c)(3). See § 1.501(c)(3)-1(d)(3). The regulations explain that the term "educational" in § 501(c)(3) includes the instruction of the public on subjects useful to the individual and beneficial to the community. See § 1.501(c)(3)-1(d)(3)(i).

You will be giving practice consultation information exclusively to your engaged practices. You will not be providing educational services to individuals or to the community. You will not be informing individuals or the public on a topic to develop their capabilities within the meaning of § 1.501(c)(3)-1(d)(3). In addition, your activities will not constitute instructing the public on subjects that are beneficial to the community within the meaning of § 1.501(c)(3)-1(d)(3).

You are unlike the organization in Rev. Rul. 74-614, supra, because you are not controlled by tax-exempt educational organizations and you do not operate as a regional computer network which these organizations and their students and faculties can use to share research and scientific information. Also, unlike the organization in Rev. Rul. 74-614, supra, you will provide administrative services to assess "member performance and provide opportunities to enhance billing practices, while providing compliance and documentation standards that meet all regulatory requirements."

Therefore, your primary activities do not further education within the meaning of § 1.501(c)(3)-1(d)(3).

### *Scientific Research*

The advancement of science is an exempt purpose within the meaning of § 501(c)(3). See § 1.501(c)(3)-1(d)(5). The term "scientific," as used in § 501(c)(3), includes the carrying on of scientific research in the public interest. Not all research or study is "scientific," for purposes of § 1.501(c)(3)-1(d)(5). Scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations.

Although you expect to develop a "patient data accumulation repository within each member practice, needed to conduct outcomes research" to share with your other engaged practices, and will analyze these data extensively to develop performance data that you will distribute to your engaged practices, these activities are not scientific in nature. You will not be conducting any scientific studies similar to those conducted in Rev. Rul. 76-455, supra, where one of the organization's principal activities was to conduct scientific studies with regard to the quality, utilization, and effectiveness of health care agencies. In this ruling, the organization studied existing health care facilities, determined methods and practices that would provide better medical services to the general public and disseminated the results of such studies to the general public. Unlike the organization in Rev. Rul. 76-455, supra, your activities involve the analysis of healthcare data to evaluate your engaged practices' performance. Your activities do not resemble any of the characteristics of "scientific research" articulated in IIT Research Institute v. United States, supra. Rather, your activities are beyond the testing or demonstration phase. Furthermore, you will distribute the acquired performance data to your engaged practices, but you have not established that you will disseminate these data to the general public.

Accordingly, your activities do not constitute "scientific research" within the meaning of § 1.501(c)(3)-1(d)(5), and in any event, research is not your primary purpose.

### *Substantial Non-Exempt Purpose*

An organization is operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. See § 1.501(c)(3)-1(c)(1).

Providing services of an ordinary commercial nature, regardless of whether the undertaking is conducted on a nonprofit basis and is beneficial to the community, does not further a charitable purpose, unless the service directly accomplishes a tax-exempt purpose. See Rev. Rul. 80-287, supra. The sale of health-related goods and services (e.g., laboratory services, pharmaceuticals, HMO services, consulting services) does not exclusively further charitable purposes because such activities serve a substantial non-exempt, commercial purpose. See, e.g., Federation Pharmacy Services, supra (sale of pharmaceuticals to senior citizens was presumptively commercial, because such activity was normally pursued by commercial enterprises); Rev. Rul. 85-110, supra (exempt hospital's provision of laboratory testing services to non-patients served non-charitable purposes); Washington Research Foundation, supra (facilitating transfer of technology from nonprofit organizations to the public through licensing

arrangements with for-profit companies is commercial in nature); and American Institute for Economic Research, supra (primary purpose of securities analysis publication was commercial).

You were founded by employees of Medical Practice, which also covers your overhead costs, including shared administrative staff. You are managed by your board of directors, all of whom are employees of Medical Practice. You will provide to Medical Practice and your other engaged practices services such as: education to provide operating efficiencies for your engaged members' business practices, a forum to capitalize on economies of scale to engage "products and services that enhance practice performance and increase the financial performance of member practices," enhance billing practices, enhance "payments by payors for services provided by members and a 'fair' sharing of cost savings realized by payors," develop a "best practices" repository, and negotiate on behalf of your engaged practices with "business and industry" to reward your members for "their cost-saving efforts."

Thus, your activities are not inherently charitable but are more like activities carried on by for-profit businesses, a factor that supports the commercial nature of your activities. See, e.g., Living Faith, Inc., supra (organization's health food stores and restaurants were in competition with for-profit organizations); and IHC Health Plans, supra (health plans resembled and competed with commercial insurance providers).

Thus, your primary activities are providing consulting services for the benefit of Medical Practice and your other for-profit engaged practices. This is a commercial business and is a cooperative enterprise that primarily benefits your engaged practices. Therefore, your activities serve a substantial non-exempt purpose under § 1.501(c)(3)-1(c)(1).

The provision of commercial services may serve primarily charitable purposes when those services are provided exclusively to tax-exempt organizations, are an essential function of such organizations, and are provided for a fee that is substantially below cost. See Rev. Rul. 71-529 (an organization that provides assistance in the management of participating colleges' and universities' endowment or investment funds for a charge substantially below cost qualifies for exemption under § 501(c)(3)), supra; and Rev. Rul. 72-369 (an organization that provides managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption under § 501(c)(3)), supra. However, you are not a membership organization providing services exclusively to its member exempt organizations; rather, you are a non-membership organization providing services solely to non-affiliated, non-exempt organizations.

Any charitable or educational benefits the public may derive from your consulting services are merely incidental to your principal purpose of benefiting your engaged practices. Thus, your activities do not primarily further an exempt purpose. Therefore, you are not "operated exclusively" for one more exempt purpose under § 501(c)(3). See § 1.501(c)(3)-1(c)(1) (an organization will not be regarded as "operated exclusively" for one or more exempt purposes under § 501(c)(3) if more than an insubstantial part of its activities is not in furtherance of an exempt purpose). Better Business Bureau of Washington D.C., Inc., supra.

*Private Benefit*

Organizations seeking exemption under § 501(c)(3) must be organized and operated exclusively for exempt purposes pursuant to § 1.501(c)(3)-1(a). An entity that is organized or operated to serve private rather than public interests cannot be recognized as operating exclusively for exempt purposes. See § 1.501(c)(3)-1(d)(1)(ii) and American Campaign Academy, *supra*. The Tax Court explained that prohibited private benefits may include an "advantage, profit, fruit, privilege, gain, or interest." See American Campaign Academy, at 1065. In determining whether an organization's activities confer an impermissible private benefit, the court in American Campaign Academy, *supra*, looked to whether the beneficiaries of the organization's activities are also the parties who founded, fund, and direct the organization.

You state that although you have no direct relationship with State Program, you intend to contract with medical practices participating in State Program after such program ends. Medical Practice is a current participant in State Program. All of your officers and directors are employees of Medical Practice, and your president is married to Medical Practice's sole shareholder. Medical Practice also provides you with office space, telephone, fax, internet, office support and office supplies for no charge, and you have no formal agreement with Medical Practice for the use of such items.

The activities of State Program, and by extension your proposed activities, are presumably intended to promote the health of each engaged practice participants' patients. However, not every activity that promotes health supports tax exemption under § 501(c)(3); "an institution for the promotion of health is not a charitable institution if it is privately owned and is run for the profit of the owners." 4A Austin W. Scott and William F. Fratcher, the Law of Trusts § 372.1 (4<sup>th</sup> ed. 1989). See also *Restatement (Second) of Trusts*, § 376 (1959). As currently structured, your activities are primarily beneficial to Medical Practice and your other engaged practices because you are focused on providing them with information that can be used in their private business activities.

For example, your consulting activities seem focused on providing financial benefit to your engaged practices. You state that:

*As value-added opportunities become evident, [you] will pursue integrating models of growth and transformation that serve [your] members [sic] independence, focusing on the proliferation of private practice, while providing supplemental support to address cost-effective operational responsibilities and services that will enhance their financial viability.*

Thus, any benefit to the patients of your engaged practices is incidental relative to the private benefit to your engaged medical practices.

In addition, your board of directors is composed of only three persons, all employees of Medical Practice. The fact that your board lacks public participation of any kind indicates that you are operated for the benefit of your directors and Medical Practice, rather than the public. Because your operations substantially benefit your directors and Medical Practice, you have not



demonstrated that your operations serve a public rather than a private interest as required under § 1.501(c)(3)-1(d)(1)(ii). See also Better Business Bureau of Washington D.C., Inc., supra, and Church by Mail, Inc., supra.

### *Inurement*

Organizations seeking exemption under § 501(c)(3) are also subject to the inurement provision contained in § 1.501(c)(3)-1(c)(2), which states that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals (often referred to as "insiders"). The inurement proscription applies to persons who because of their particular relationship with an organization have an opportunity to control or influence its activities. The owner and employees of Medical Practice are insiders because they are in a position to have control over your activities through participation in and influence over the board of directors and your activities.

Your primary purpose is providing training, consulting, and cost-saving programs for your engaged medical practices, including Medical Practice. You will provide such services for no charge to Medical Practice, a commercial business. This transfer of your financial resources to the owner of Medical Practice is in violation of the inurement proscription and is also sufficient to defeat exemption under § 501(c)(3).

### Conclusion

We have concluded that you are not organized and operated exclusively for charitable purposes under § 501(c)(3). In addition, your activities violate the prohibition against private benefit under § 1.501(c)(3)-1(d)(1)(ii) and the prohibition against private inurement under § 1.501(c)(3)-1(c)(2). Therefore, we cannot recognize you as an exempt organization under § 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS*.

*and Power of Attorney.* All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service

1111 Constitution Ave, N.W.  
Washington, DC 20224-0002

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations